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FEEDING THE TIGERS:
U.S. BILATERAL ECONOMIC ASSISTANCE
IN THE REPUBLIC OF KOREA AND THE REPUBLIC OF CHINA

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The Republic of Korea (ROK) and the Republic of China on Taiwan (ROC) are the two of Asia's celebrated "Four Tigers" which may properly be regarded as having national economies. The economic, social and political success attained by these two nations and the significant support which they have received in that process has led to a seemingly endless analysis. The key argument has been that if foreign aid can be demonstrated to have been significant in their achievement of such rapid progress then their experience can be transferred to other struggling nations.

The economic miracles of Korea and Taiwan are well documented. In each there was a single-minded determination support national independence and, in the process, to escape poverty and demonstrate the superiority of their governments and systems over those of their Communist countrymen. Economic success was a means to an end. It was a weapon to be used against dangerous and ever-present enemies and, as such, was required to be efficient and productive. The policies and systems which leaders in Korea and the ROC sought were those which worked.

The paths to success of these two tigers were very different. Taiwan moved quickly following 1949 to establish the economic conditions for a rapidly growing economy in order to support its massive defense requirements. It is often forgotten in the clamor of the "China Lobby" that U.S. support for the ROC immediately following the escape to Taiwan was luke-warm at best. U.S. officials had long since lost patience with Chiang Kai-Shek's corrupt and ineffective government. U.S. assistance began to flow in 1951 following the invasion of South Korea and a renewal of U.S. concern for the Communist threat in Asia. By that time much of the groundwork for future success on Taiwan was underway.

Korea faced a more certain flow of assistance if not a brighter future economically. The U.S. had partitioned Korea at the end of World War II as part of its misguided appeasement of the Soviet Union. The invasion by Kim Il Sung and Mao Tse Tung finally awakened the Truman administration to the realities of Communism in Asia.

The moral responsibility for South Korea's security rested clearly and completely with the United States. Syngman Rhee's post-war government was adept at using this responsibility as a lever for prying massive economic assistance from the U.S. As with African programs of later years, the guilt stimulus of the aid flow meant that there were few economic policy strings attached and those which existed were easily ignored. Only with the reduction of aid beginning in 1958, the toppling of the Rhee

government and the economic reforms begun by Park Chung Hee in 1961 was economic policy intentionally turned toward growth.

On Taiwan the new ruling elite were from the Chinese mainland and viewed Taiwan as a temporary resting place prior to their return to their rightful position at home. Under the Japanese, Taiwan had been administered in a manner very similar to Korea. The economic bond with Japan was, however, much looser. Korea was intended to be an integral part of the Japanese home economy, a gateway to Manchuria and the Chinese heartland. Taiwan was to be a source of basic raw materials and agricultural products.

The rulers who came to Taiwan from the mainland brought with them a superior level of education. From the beginning, most of the technical people on Taiwan had been trained in U.S. universities and there was a long tradition of contact between the kind of people represented by the foreign aid administrators and their Chinese opposite numbers. Korea was markedly different. There were fewer people with university training since the Japanese had restricted Korean access to higher education. Among Korean aid administrators prior to the Park period, very few had been to the United States or shared the same educational experience as the aid administrators with whom they worked.

The major similarity of these two economies was poverty. At the beginning of their drives to industrialization they were the poorest nations in Asia. At the end of the Korean war, South Korea lagged behind every nation in Asia including the Indian subcontinent. At the time, both nations could look to the Philippines as a target for their aspirations.

In the final analysis, the economic miracles of the ROC and ROK were simple matters from a policy point of view. Market-oriented allocation mechanisms were introduced which distributed resources according to prices rather than fiat. Economic assistance was used initially in the process of implementing these policies as a substitute for domestic savings and private capital flows if not always in the manner prescribed by aid administrators. In both economies, however, when the composition of aid turned from grants to loans, market pricing led to an almost immediate shift from official to private capital flows.

It sounds easy and, therefore, begs to be transferred to other nations which have struggled for decades with the issue of economic development only to remain poor.

The problem is that the question of "how" is inadequate. The question of "why" the ROC and ROK succeeded while others failed is central to transferring relevant lessons both to poor nations and to the aid agencies of their wealthy benefactors.

The analysis which follows is designed to link the how and the why of economic growth. In some cases, there exists no direct evidence of why one policy was chosen over another. The reasoning can only be inferred from the choices. In many cases, the issue arises only because the policy choices of the Koreans and Chinese conflicted with those prescribed by "development economists." No American entrepreneur would find the choices anything but natural.

THE COMMON FACTORS IN ROK/ROC AID

Despite the differences in starting conditions of the two economies, there were a number of essential common factors in their economic policy formation including administration of foreign aid programs. Given the success of the two economies, these factors may be candidates for a list of necessary conditions for a successful aid program, i.e., in their absence an aid program is unlikely to be successful and, therefore, should not be undertaken with the goal of economic growth.

1. Single Donor: Each nation had a single aid source: the people of the United States.
2. Joint Administration: The ROC and ROK governments jointly administered every aspect of their aid programs with U.S. officials. In the case of the ROC, aid administrators were individuals immediately responsible for the economic success of the nation.
3. Common Education: In the case of Taiwan, officials from both sides had received the same education. Almost all held Ph.D. degrees from top U.S. universities. In Korea, President Park brought in as senior advisors recent U.S. graduate economists although there was less participation by them in the aid program per se than in economic policy-making. In Korea, U.S. military training played a significant role.
4. Lack of Vested Interests: The ROC government, recently transplanted from the mainland, had no vested interests in the economy on Taiwan. In post-war Korea there was virtually no productive enterprise in which to have a vested interest. In every sense of the word there was as close to a level playing field in these countries as is possible to achieve.
5. Incentive Driven Productivity Advances: In both countries, agricultural and industrial economic policies were designed around market incentives. Production decisions were made in relation to the

market rather than in relation to ideological or philosophical beliefs.. Resources for increasing productivity were channeled to those areas where profits were possible.

6. Basic Economic Relationships Respected: In major economic decisions, notably the much discussed land reform programs, basic economic relationships were respected. Property rights were respected for both old and new owners with the former receiving genuine payment and the latter an immediately enforceable property right. Land transfers made owners not out of peasant tillers but out of the traditional managers of the farms, a significant difference and one almost totally ignored in recent efforts at land redistribution.
7. Import-led Growth Policies: Imports were of great importance to the economic policy makers of Taiwan and Korea. There was an explicit recognition that people work for rewards and that, after basic survival is achieved, their level of effort depends to a great extent on the material rewards to be achieved.

A SINGLE DONOR

In the current climate of multiple aid donors, each with its own priorities and policy views, it is difficult to imagine the relative ease of administration achievable with a single donor. Not only were the donor and recipient able to build a more solid working partnership, they each knew that the success or failure of their enterprise rested on them alone and that they would be judged accordingly.

From the Chinese side, there were no opportunities for shopping around the pet projects of a given official or interest group. Moreover, continued presentation of bad projects could be expected to lead to a reduction or cessation of aid. With no alternative sources this was to be avoided at all costs.

From the U.S. side, there were two clear challenges on Taiwan. First and foremost was enticing the Nationalist government of Chiang Kai Shek to aid in the defense of South Korea. Startled into action by the invasion of North Korea, U.S. aid began to flow almost immediately. The value of a strong ally on Taiwan in the event of Mainland intervention in Korea was apparent, if only after the invasion. Second, the newly felt Communist threat required a demonstration of superiority over the Communist system.

Much has been made in the literature of the wise husbanding of aid resources by ROC officials. The existence of a single donor was partially responsible. Unlike the World Bank, the United Nations and other multilateral (and some bilateral) aid sources, USAID did not take as its measure of success the level of taxpayers dollars sent abroad. Therefore, there was no insistence from the donor on yearly increases in aid flows.

This point is hard to overemphasize. There are currently more than ten major aid donors. Each competes for projects and each owes its bureaucratic position to levels of lending rather than to levels of economic growth in recipient nations.

Taiwan and Korea were under constant pressure to achieve economic independence rather than to absorb more aid. They were under intense pressure to undertake political reforms as well, particularly in Korea. Beginning in the mid-1950's, the U.S. increasingly tried to use the aid lever to persuade Syngman Rhee to democratize his government and reduce the level of corruption which surrounded him.¹ On his part, Rhee put at the top of his policy agenda the extraction of as large an amount of U.S. aid as possible. To this end, the Korean government regularly understated the size of their agricultural output and used much of their extremely scarce professional economic manpower for the production of spurious projections based upon the now discredited "two gap" economic models. A perverse result was that U.S. aid was significantly and rapidly reduced just as the reforms of the Park government were taking hold.²

Another issue which should not be overlooked is the relationship of military assistance to economic assistance. First, the vast majority of all aid which went to Taiwan was for security. Of the total of US\$4.0 billion provided to Taiwan from 1951 to 1965, US\$2.5 billion was for military assistance.³ For the U.S. Congress, the security situation was the major justification for economic assistance. Current programs of military assistance continue to be bilateral and cooperative while economic assistance is primarily multilateral and competitive.

The Korean situation was similar if somewhat less elegant. Aid to Korea was initially provided in profusion to bolster a political ally at a time of great poverty, national economic chaos and under threat of armed invasion. It was continued for a decade to maintain relative stability despite economic policies which were roundly condemned by the U.S. officials who administered the aid program.

Economic aid to Korea began to decline at a time when Korean policies had changed and rapid autonomous economic growth was under way. The decision to reduce economic aid had more to do with the stabilized security situation along with competition

from the emerging African states with their strong constituency within the Kennedy Administration than with cooperation on economic policy.

JOINT ADMINISTRATION

Unlike any current major aid programs, the ROC and ROK programs were jointly administered by the donor and the recipients. This was true at every level of the administrative hierarchy for both military and economic assistance. In Korea, U.S. assistance went clear to the grass roots as was demanded by the decimation of South Korea's manpower by the war. Cooperation was more genuine and fruitful on Taiwan than in Korea due to the problems with the Rhee government cited previously. Both, however, went to a cooperative level politically impossible today.

The Economic Stabilization Board and the Joint Commission for Rural Reconstruction (JCRR), both in the ROC, provide useful examples.

The Economic Stabilization Board was created in 1953 to enhance cooperation and to coordinate efforts which had been previously directed by USAID on the American side and the Council for U.S. Aid (CUSA) on the Chinese side. It was chaired by the Deputy Prime Minister who also chaired CUSA. Chinese members included the Minister of Finance, Governor of the Central Bank, the Commissioner of Safety and the Chairman of JCRR. U.S. members included the USAID director, the economic counsel of the U.S. Embassy, and the chief economist of USAID mission.

The ESB was divided into four operational committees each of which had an American member. Thus, the joint nature of policy decision making from the ESB was continued in joint implementation by the operations staff.

The JCRR was created in 1948 prior to the loss of the mainland. When it was moved to Taiwan in 1949, there were five commissioners. Two were appointed by the U.S. president, three by the Chinese president. The Chairman of the commission was selected from the Chinese members. Under the commissioners were about 30 senior staff. In most years, 10-15 of these were American. The remaining were Chinese who, in almost every case, had been educated in the U.S.

By 1959 the United States was spending more aid money in Korea than anywhere else. The Office of Economic Coordinator (OEC), which administered the aid program at the time, was involved directly in transportation, power, industry, agriculture, mining, public works, communications, community development, health and sanitation, program information, and

participant training. There were some large scale construction projects (the show pieces of foreign aid programs elsewhere) but the direct presence of the U.S. administrators at the lowest levels also permitted a multitude of very small scale projects.

The support provided by the U.S. did not become lodged at the top of the economy but instead permeated every level. Aid projects involved railroad cars, repair shops, small and large electricity generating plants, flour mills, fertilizer plants, and small roads as well as major highways. Aid administrators were found everywhere. Irrigation, hospitals, public wells, publications, classrooms and the curriculum of the schools which used those rooms, telephone lines and switching equipment, and housing, the list seems incredible beside the relatively few big projects conducted by our largest foreign aid programs today.⁴

COMMON EDUCATION

Much is made in the "development community" of the need to establish a common ground between aid donors and recipients. This usually is required for the donor to understand why the recipient wastes scarce resources. In the case of Taiwan throughout and Korea in the later periods, the problem of mutual understanding did not exist.

The vast majority of officials in the ROC government were U.S. educated. Indeed, most of those at senior levels of groups such as the JCRR held advanced degrees from top U.S. universities. In their discussions of policy there was no need to establish a common ground of theory or historical context.⁵

On economic issues, this common ground had a further aspect which is decidedly different from later experience. All of the economists participating in establishing the policies which led to the economic miracle, American and Chinese, were trained in classic Marshallian economics. The behavioral theories on which they based policy prescriptions were those of marginal analysis both for the individual and the firm.

All of those who established the basic policies on Taiwan were educated prior to the infusion of either Keynesian macroeconomic theory or "development economics" into the curricula of U.S. universities. To be sure, these ideas were in the universities of the time and were driving forces in U.S. and European policy debates. However, the fundamental training of the individuals involved in forming economic policies on Taiwan had not included them. Later participants, especially the Harvard group which poured into Washington and Taipei in 1961, were filled with the new theories. By the time of their arrival, however, the die was cast.

In the years immediately following the WWII, Korea was markedly different. There were fewer people with university training since the Japanese had restricted Korean access to higher education. Of those who had been to university very few had been to the United States or shared the same educational experience as the aid administrators with whom they worked.

With the arrival of Park Chung Hee this situation began to change. With the return to Korea of men such as Dr. Nam Duck Woo in the early 1960's, Park found a ready source of economic talent. It is interesting to note that these Korean economists did not, in general, come from the same level of U.S. university as had their Chinese counterparts. The Koreans had attended such universities as Oklahoma (Nam) and Missouri (Kim Mahn Je) which, unlike their Eastern counterparts, had not accepted the non-market ideas of "development economics."⁶

More importantly, Park and his fellow military men were themselves the product of U.S. training. They were the first generation after the colonial period and were Western trained. Six thousand had been to the U.S. for training.⁷ These men had learned well the requirements of managing a modern war machine and represented the most highly trained institution in Korea.

LACK OF VESTED INTERESTS

Entrenched vested interests have plagued the attempts of almost every nation at making the transition from a stagnant to a growing economy. Always the product of government collusion with politically well-connected economic interests, these vested interests stymie economic growth by blocking moves to establish market driven solutions to economic problems. The post-revolution Aquino government in the Philippines is a prime example.

In the early years, both Korea and Taiwan faced economies almost devoid of vested interests. In both, war played an important role as major portions of the economic and social bases were destroyed. This was particularly true of Korea where millions were left homeless and wandered as refugees.

On Taiwan, the peculiar political situation played an important role. When the Nationalist government fled to Taiwan in 1949 it totally absorbed Taiwan from a political and military point of view. Taiwan had always been a province of China but had been occupied by Japan since 1895. Following World War II, the growing crisis on the mainland had precluded active Nationalist activity on Taiwan which would have led to the establishment of economic vested interests. There was neither a government ministry presence nor an economic presence.

Once the Nationalists fled from the mainland, the government was faced with a virtual tabula rosa from a policy standpoint. Economic policy had a single focus: build as rapidly as possible an economy which could support the required military expenditures. With the exception of those industries believed essential to national security (and in this context the Chinese were more concerned with preparations for war than with the more esoteric notions of national security which have plagued later economic policy makers), economic policy makers faced their task without preconceived notions of "appropriate" industries or sectors.

Of course, there was great concern for the agricultural sector. The Communist regime on the mainland had skillfully exploited peasant grievances to advance its war on the government. However, within the agricultural sector itself, there were few preconceived notions. One great advantage faced by the ESB and the JCRR was the total absence of a dedicated agricultural bureaucracy. The Ministry of Agriculture and Forestry itself had been disbanded along with many other government bureaucracies in 1949. Functions deemed to be essential were transferred to a department under the Ministry of Economic Affairs. Thus, the special interests normally found in a ministry were subordinated to the overall economic health of the nation.⁸

The industry of Taiwan was similarly stripped of vested interests. The major corporations had been state-owned under the Japanese.⁹ Government officials coming over from the mainland, however, had none of the usual concerns which bureaucrats have for such corporations. These were not their companies. Moreover, they had little concern for the native Taiwanese managers or workers. As with agriculture, this lack of vested interest yielded the flexibility required for policy reform.

In Korea the pattern was similar if for differing reasons. The Japanese had left in Korea a significant industrial economy. In addition to the estimated 2,400 Korean-owned manufacturing factories, from the departing Japanese the "Republic of Korea inherited 2,500 operating industrial and business enterprises, as well as infrastructure, inventories, real estate, and 15 percent of the nation's land."¹⁰

Unfortunately, the Japanese left Korea without a governing elite and with managers and technicians unused to controlling a major enterprise. As history has shown there is no scarcity of top talent in Korea but Koreans had to take over with little warning and, due to the American administration, without complete control. For its part, the American administration which took over in 1945 had almost no interest in Korea and "managed" with that attitude. Understandably, they just wanted to go home.

The rudderless Korean economy was far from adjusted to the new situation when it was further devastated by the Korean War. This lengthy conflict saw armies fight their way the length of the peninsula several times before an armistice was achieved. The degree of devastation in Korea is hard for people today to comprehend. The country was an inhospitable desert by comparison with Taiwan.

While some enterprises emerged from both the post-WWII neglect and the devastation of the Korean War itself, they were economically insignificant in the national economy.

The political situation in Korea under Syngman Rhee was more complex. Rhee himself had been out of Korea since 1912. The majority of his supporters and high officials were patriots of the colonial resistance. As such, they were essentially outside of the contemporary attitudes in Korea. Rhee and his government never succeeded in consolidating power in a meaningful sense. The Korean War interrupted all political progress. The Rhee government lasted in the post-war period only until the security situation was sufficiently stabilized for it to be overthrown.

The military government of Park Chung Hee was not of the Korean elite, however these are defined in such a chaotic period. It was made up of men of practicality rather than ideology. Although not outsiders as in the case of Chiang's government, they were outside of the traditional economic power bases. Hence, they had the same lack of concern for the selection of economic winners and losers in a new Korean economy. Their concern was that the economic policies - or lack of policies - of the Rhee government were plunging the nation into economic chaos with the potential of tempting Kim Il Sung to test the resolve of United Nations forces.

INCENTIVE DRIVEN PRODUCTIVITY ADVANCES

In both agriculture and industry, economic policies were designed around market incentives. As with other positive aspects of the Korean experience, these were delayed until the Park reforms but the patterns in both the ROC and the ROK were the same. Crops were grown and products manufactured to satisfy the demands of ready customers.¹¹ The decentralization of the Taiwan aid program, which placed those allocating scarce resources close to the end user, was important in gaining this efficiency.

Even more important, however, were the interest rate policies which recognized the real value of resources. Since the aid programs were never large enough to replace private capital flows, end users of capital were not tempted to waste it in response to an artificially low price.

The Korean experience with development of credit markets is particularly instructive. The role of a financial system in any economy is to mobilize domestic savings and allocate the resulting investment resources to the most productive user. In most of the less developed nations, governments pursue policies which keep interest rates below market levels in the misguided belief that a faster rate of investment will thus take place. Officially, Korea in the early years after World War II was no exception. However, there was one distinct difference between Korea and the rest: the Korean government permitted the evolution and continuation of a widespread capital market outside the regulated banking and credit system.

This unorganized money market (UMM) had two effects. One was to make loans available to borrowers who were prepared to accept the higher cost of borrowing for more risky purposes, entrepreneurs. The second effect was to ensure that interest rates were higher for those borrowers who would have difficulty getting loans from the official and regulated banks. Higher interest rates in the UMM performed two functions:

1. They ensured that loans went to the most productive activity available and not to individuals favored by the government.
2. Higher interest rates led to higher rates of saving among those who used the UMM. The UMM came to represent up to 50% of the total savings in the national financial system.^{1,2}

A major bottleneck in autonomous economic development has been the lack of access to working capital for the vast majority of the small productive enterprises in the economy. Centralized allocation of financial capital, credit through state cooperatives, and the tying of most loans to tangible assets, has usually been the policy of aid supported governments. The curb market helped Korea to have the aid sponsored institutions and to follow the aid supported policies for credit distribution but at the same time permit a healthy domestic credit market to allocate working capital where its productivity was highest. This factor in Korea's success cannot be overstated.^{1,3}

..., in an economy characterized by labor surplus, the predominance of the primary sector, and a small light-manufacturing base, the majority of borrowers as well as lenders would have consisted of agriculturalists, small firms, and small retailers and wholesalers, who would require financial resources for short-term periods distributed in very small blocks, as compared with an economy dominated by the non-primary sectors. Consequently, in a competitive situation without government intervention,

these characteristics of lender and borrowers would have been conducive to the development of regionally based and atomistic money and capital markets consisting of many small-sized and specialized financial institutions. This, in fact, was a role played by the unregulated money markets in Korea.¹⁴

Whatever arguments may occur about the overall role of financial liberalization on the rate of economic progress, the fact remains that when interest rates were allowed to rise in the regulated financial sector to something close to a true market level in 1965 there was a dramatic expansion of the banking system. The savings which had heretofore been distributed through the UMM found their way rapidly into "legitimate" financial institutions following partial deregulation.

Just as market pricing of credit led to its efficient allocation, a similar situation existed for productive inputs. Although scorned at the time, the unofficial "reallocation" of some aid commodities played an important role in increasing efficiency.

Of the \$24 million worth of U.S. fertilizer, supplied each year for sale to small farmers at fixed prices, a 'sizable' proportion had actually wound up on the open market at double the price. The fortunate middlemen: Rhee's Liberals.¹⁵

Distributing resources at a price below the value of their productivity will result in their dissipation through being put into the hands of those who do not have the ability or the willingness to use them most productively. President Rhee's friends had every incentive to ensure that the fertilizer ended up where it would be most productive and hence do the most good.

On the production side, market determined pricing played a similar role. The case of banana growers on Taiwan provides an insightful lesson on resource management as well as the importance of open international markets.

Banana farmers were casual in their attitudes toward soil erosion and maintenance of banana plants until the Japanese liberalized their quota system in 1963. To that point, banana exports had been limited to US\$8 million annually. With the quotas liberalized, exports rocketed to US\$50-60 million per year after 1968, an amount equal to total U.S. aid in previous years. At once farmers began to improve soil conservation techniques and, importantly, stake individual banana plants with bamboo against the winds of yearly typhoons.¹⁶

Over the entire period, rice declined in importance for Taiwan's farmers. This was largely due to the tax imposed on rice through the government stabilization program. This program required rice to be delivered to the government at set prices. The land reform program, however, had left farmers free to determine their own crop mix. In short order, they moved from the high tax to the low tax crops. Thus, the politically sensitive price of rice - considered to be an issue meriting interference with the market - was controlled without interference in other allocation decisions.

BASIC ECONOMIC RELATIONSHIPS RESPECTED

In order for any economic system to operate as an efficient allocator of resources and, hence, as a system which maximizes income and growth, it is necessary for the basic economic relationships, both legal and customary, to be respected. As with most economic phenomena, this is little more than common sense. As such, it is most open to political manipulation and the theories of academics.

One of the major factors in the success of the ROK and ROC has been the respect for property rights and the economic values associated with them. Nowhere was this better demonstrated than in the highly successful land reform programs conducted in both countries.

The essence of land reform is to disrupt patterns of existing property rights so that markets for land allocate any given piece of land to its most productive use. Often, this is accompanied by a justification based on the "inequity" of existing property rights or "injustice" in the manner in which they were created. The term land reform implies that reallocating land to a new set of owners is an economically significant act. Only under very unusual circumstances, however, will this "significance" be positive.

Any discussion of property rights must begin with the recognition that all property rights were originally established through force and distributed for the good of those with the strength to establish them. Where this distribution was accomplished with an eye to the welfare of the society and with an equitable system of acquisition and transfer of property rights, the mandate of the original power has been left relatively unquestioned except by radical elements.

Where distribution has not been accomplished with an eye to the general welfare and where the system of acquisition and transfer has not been equitable, calls for reform of land tenure arrangements have almost always been heard.

The difficulty of reordering land tenure, however, is that it requires a fundamental reordering of all property rights in the society. This is true because the property right in the land represents not only a claim on the output of the land but a vested interest in the continuing output of land as a resource which can be passed through the generations.

A great mistake of honorable land reformers is to believe that those to whom they would transfer land have different intentions from those from whom they obtain title. In fact, their interests in perpetuating themselves and their families are identical.¹⁷

The political objective in land reform is to increase the stake of those working the land in the economy and society without alienating those from whom property rights in the land are taken. The process is nothing more than a Pareto optimality exercise but one in which people die from starvation, war or both if the formula is not correct.

The ROC and ROK governments were fortunate to get the formula right. Two factors were in their favor. Most importantly on Taiwan, none of the new ruling elite had a vested interest in continuing existing land tenure patterns. For those newly arrived from the mainland, there was little concern for the property rights in the land of native Taiwanese.¹⁸

In Korea, the tremendous landholding of the Japanese, who had taken over almost all lands not previously under cultivation, made the exercise less disruptive.

A second factor on Taiwan was the availability of the four major government corporations. As with the land rights, the newly arrived mainlanders had little concern for the ownership distribution of these former Japanese government companies. Therefore, if economic planners found it expedient to distribute shares to the former land owners and this could be accomplished with no harm to the national security, there was little objection.

The land reform on Taiwan was conducted with conscious regard for the economic relationships involved. Land owners were viewed as people having a stake in the production of society if exhibiting little regard for those producing it. Instead of confiscating their property right, it was traded for a property right in another productive segment of the economy.

A significant part of the land reform success can be attributed to this perspective. Other attempts at altering traditional property rights, notably in El Salvador and Vietnam, have resulted in alienation and, inevitably, bloodshed between those whose lives were meant to be bettered.

Another important aspect of the Taiwan land reform was that it did not disrupt managerial responsibilities. The tillers of land on Taiwan had traditionally been farm managers as well. Little land was taken from professional managers and transferred to common laborers. Thus, those who gained property rights were fully capable of administering in an economic sense their stake in the economy.

This is not to say that farm laborers might not, over time, gain equal skill. It merely demonstrates that continuity in land management coupled with establishment of an equitable system for the guarantee and transfer of property rights leads quickly to stability as well as to long term benefits.¹⁹

A final aspect of the land reform on Taiwan which corresponds to that of Korea and conflicts directly with those of many current attempts is that the new land owners were provided with genuine property rights. As soon as the land was paid for, the owner had the right of sale. If this meant an accelerated payment schedule was required, it was allowed.

The result was that farmers became masters of the fate of their families. They were free to continue in the competitive world of intensive agriculture or to move on. The right to capital earned through past labor truly was vested in themselves and not tied to the form through which that capital might be represented at a particular time.

The ability to take a genuine title and right of sale also avoided trapping valuable labor in agricultural pursuits as real profits and wages rose in industrial enterprises. A farmer could transfer his capital to industrial pursuits or use the income from his capital to underwrite new ventures. Flexibility was, and remains, the key to the economic success.

The overall effects of land reform were less striking in Korea where the most significant results were political as much as economic. In 1912 the Japanese colonial government of Korea replaced the prior system of ill-defined ownership with a set of strong legal guarantees on the private ownership of land. At the same time they carried out the first complete land survey undertaken in Korea. In the process the government acquired ownership of about 58% of the agricultural land in the country.

In 1947 the U.S. military administration, which had replaced the Japanese at the end of the war, redistributed the land of the departing Japanese to Korean farmers. Subsequently the Korean government carried out several further distributions of land ownership so that while only 16.5 percent of the rural population owned land in 1947, 71.2 percent owned their own land by 1974. These reforms were widely supported in the countryside

but not by the Rhee government. In fact, the reform legislation was passed over Rhee's veto and led to retaliations against political opponents and the press.²⁰

Until 1971 the Korean government's policy was to use PL480 food imports under the U.S. foreign aid program to keep the urban price of food below market cost. Although the productivity of the Korean farmer was artificially low for over 25 years after the initial reform, land ownership was a major factor in ensuring a relatively even distribution of income in Korea. Also, the pattern of land ownership helped to support the pervasive and unregulated domestic capital and credit market which was so important to the Korean economy when economic growth got underway.

Land reform in Korea had a much smaller effect on industrialization than on Taiwan. One factor was the chaos surrounding the industrial facilities taken over from the Japanese. As noted earlier, the combination of poor administration by the U.S. occupation and the lack of top management experience left Korean industry in disarray. Following the war, it simply did not exist in meaningful terms.

IMPORT-LED GROWTH POLICIES

Corruption and mismanagement figured large in press reports of the U.S. aid program in Korea. By its very nature and the degree of fungibility involved, any aid program which transfers funds to foreign government officials will have the same problems whether they are visible or not. In the Korean case the Wall Street Journal produced some scathing reviews. In 1964 it was reported that the Korean aid program was out of control. A major complaint was that:

The U.S. intended that its aid dollars be spent at least in part, on factories capable of turning out products for export or to replace products that would otherwise have to be imported. Instead, local businessmen, with government help, have lavished foreign exchange on equipment for plants to make lipstick, cigarettes, stockings and similar items -- mainly for the local market.²¹

The article in question went on to complain that the Korean government was using U.S. aid funds to import television sets, musical instruments and other luxuries. It was asserted that aid officials were being naive in allowing the Korean government to decide what it would import with our money. Furthermore, the article described the dangerous state of the Korean economy, with massive unemployment, rising inflation, rapid population growth, and faced with the necessity of importing most of the resources required to run an economy.

The Koreans did indeed invest in the production of what the aid observers and other outsiders chose to call luxuries. It is quite clear that they also used some of their artificially scarce foreign currency to purchase imports which did not match the requirements of the planning models of the time. In the light of the ultimate performance of the Korean economy we can only assume that they were doing something right.

In fact, there is a strong argument that the Koreans of the early 1960's were laying the appropriate foundation for the economic miracle to come. It can also be argued that the expenditure of foreign aid on these so-called luxuries was a more productive use of funds than the spending on capital intensive projects which were so popular at the time.

The explanation lies in the acceptance of two postulates:

1. Economic development is about people. It occurs when people are willing to work and sacrifice for rewards which will come to them as individuals in the foreseeable future.
2. Baubles and pointless luxuries to the outsider may be the stuff of dreams to the person who must do the work and make the sacrifice.

Given suitable incentives people are capable of economic success in a nation as crowded and resource poor as Korea. With unsuitable incentives they are capable of economic stagnation in a nation as sparsely populated and as resource rich as Zaire.

Economic planners always work from an esoteric world of models and factors of production. Real people work for dreams and goals which directly involve themselves and those they love. The outsider cannot know what will motivate individual people in the longer run. The outsider cannot know the lengths to which some individuals will go in pursuit of the dream represented by a trinket or toy.

To the extent that the Koreans circumvented plans for developing their economy and used U.S. aid to create incentive goods they may have laid a real foundation for a successful economic future.

The pattern of export incentives developed under Park indicates a continuing recognition of the importance of imports. Almost every export promotion incentive involved access to imports. Most important among these was the right to virtually unlimited imports of raw materials with an accompanying right to resale in the protected local market. While solid data are not available, the rush of entrepreneurs to the thinly profitable

export sector indicates that profits from sales of restricted imports were a substantial incentive to enter export industries.

In combination with factors such as well-defined and enforceable property rights and limited government intervention, the availability of imported incentive goods became a critical factor. Until the mid-1960's Korea's economic performance was no better than that of other less developed nations. Furthermore, up to that time Korea restricted imports of "non-essentials".

The Korean balance of trade remained fairly stable until the end of the period. When the policy of export led economic development began under the Park regime a startling change in the balance of payments data took place: imports grew faster than exports until well into the 1980's. If there was a leading sector it was imports and not the increase in exports which followed.

Table 1
Imports, Savings and the Balance of Payments
South Korea: 1956-1971
(millions of US\$)

<u>YEAR</u>	<u>IMPORTS</u>	<u>SAVINGS*</u>	<u>BOP</u>
1953	109.4	-3.8	-92.4
1954	78.1	2.7	-67.8
1955	104.8	1.0	-91.9
1956	122.4	-0.4	-110.9
1957	144.8	-1.6	-129.2
1958	125.3	0.4	-105.6
1959	102.6	2.4	-79.7
1960	117.5	1.7	-90.1
1961	106.6	4.0	-68.4
1962	141.2	4.8	-98.2
1963	179.2	4.2	-133.0
1964	133.3	5.7	-76.2
1965	149.6	9.1	-69.3
1966	237.9	11.7	-115.6
1967	320.7	13.9	-154.7
1968	468.0	15.6	-233.0
1969	583.8	17.0	-273.7
1970	642.4	16.5	-261.2
1971	773.6	14.3	-314.2
1972	801.2	15.5	-157.9

Source: Bank of Korea, Economic Statistics
Yearbook, 1973. pp.260-261.

*As a percentage of GNP

Taiwan was intriguingly similar. The initial conditions of a respect for private property were established through effective land reform and the domestic capital market operated despite government policies to constrain it. When imports were liberalized - earlier than was the case in Korea - the rate of economic growth and the level of exports exploded.

Until the surge of exports at the end of the period Taiwan's imports grew at a faster rate than imports. Later, with the exception of two years while Taiwan was adjusting to the oil price shocks of the 1970's, its balance of payments moved into a surplus and grew at an accelerating rate. Note that it was only after 1965 that Taiwan liberalized the import market in parallel with the domestic credit market and these are the factors which in combination spurred economic growth.

Table 2
Taiwan Merchandise Imports 1950-70
(millions of US\$)

<u>Year</u>	<u>Imports</u>	<u>BOP*</u>
1950	123.90	-30.80
1955	184.70	-57.60
1960	286.50	-122.50
1965	517.20	-66.40
1970	363.40	105.20

Source: Financial Statistics
Monthly, Central Bank of
China. Various issues.
* Balance of Payments
on Merchandise trade

We have already made the point that U.S. aid paid for a substantial portion of Korea's agricultural imports in the early years. It is interesting to note, however, that total imports continued to rise as the aid funded portion declined. This might indicate that with appropriate domestic economic policies the commodity import portion of the aid program was at best marginally important for Korea's economic success.

Similarly, the standard assumption that imports are inversely related to the level of domestic saving is not borne out in the Korean case. Table 1 shows that domestic savings rose as a percentage of GNP as the level of imports increased. The plausible explanation for this is that the availability of imports is an added incentive to save. The tangible presence and availability of desirable goods may be a strong incentive to consumer behavior which we observed in the United States in the

past when consumer credit was less readily available: people saved to buy what they wanted but could not afford at the time.

Again it is interesting to note that the same thing had happened on Taiwan under similar circumstances several years before. With import liberalization the rate of domestic savings rose.

Table 3
Net Domestic Savings on Taiwan
As a % of National Income
(1952-75)

YEAR	SAVINGS % of NI
1952	5.2
1955	4.9
1960	7.6
1961	8.0
1962	7.6
1963	13.4
1964	16.3
1965	16.5
1970	23.8
1975	25.3

Source: Taiwan Statistical Data Book, 1981. As quoted in Tsiang, S.C., "Taiwan's Miracle: Lessons in Economic Development," in World Economic Growth, Case Studies of Developed and Developing Nations, Edited by Arnold C. Harberger, ICS Press, San Francisco, 1984. Table 6, p.319.

Until the late 1950s the Korean government followed a restrictive import and foreign investment policy. After 1962 both were reversed. Imports had been liberalized considerably during the late 1950s and in 1962 the incentives for foreign investment were increased substantially. All restrictions on the proportion of foreign to domestic ownership were removed as were all restrictions on the repatriation of profits. Korea borrowed abroad in substantial amounts at the same time. The fungibility of funds means that the foreign exchange made available by foreign direct investment and foreign borrowing permitted the balance of payments to support the trade deficits which resulted from the rapid increase in imports.

A footnote to the increased flow of imports which began in the 1960's is its relation to import substitution. The Korean government of President Park followed a two-pronged policy of export promotion and import substitution. The rising tide of imports would indicate that the import

substitution part of the program was not very effective in the short-run. We cannot say when import substitution took over as a natural part of the growth process, but it was not in the years when the government was most actively pursuing an import substitution policy.

THE CHRISTIAN MISSIONARIES

Earlier we cited the importance of common education to the success of aid efforts in the ROC. As much as imparting a common economic frame of reference to administrators on both sides, their common educational experiences provided them with a common cultural experience. In Korea prior to the mid-1960's this commonality through education was lacking. What was present in Korea, however, was a cultural and spiritual influence at once more profound and lasting - the Christian missionaries.

The Korean Christian churches and American missionaries kept alive the flame of Korean nationalism during the half century of Japanese occupation. As the major non-Japanese external influence, they had a profound effect on the traditional cultural and political relationships of Korea. Between 1952 and 1962, forty-one percent of the members of the cabinet came from the 8 percent of the population which was Christian.²²

The churches did more than provide food, clothing, medical services and religious consolation to people in need. They were responsible for a substantial amount of grade school and high school education and much of the university education. The first modern university in Korea was founded by Underwood, the missionary who is still revered as a national figure in Korea. In the strongest sense they provided direct foreign aid.

A stated aim of foreign aid administrators has always been to work themselves out of a job, to replace themselves with locals as soon as possible. The missionary element of the Korean churches seems to have been peculiarly adept at this. They consistently developed local skills and then retired from the scene. Evidence indicates that the churches operated a lean administrative structure and that a high proportion of their limited funds went into direct action.

The churches in Korea did as much of their training as possible locally, and when they wanted to send Koreans abroad they sent them to institutions which gave highly specific training and cost as little as possible in the process. Furthermore, their idea of appropriate education and training was based upon the experience they had gained establishing and running schools and universities in Korea.

They built on a U.S. model modified in the light of their experience in Korea and other less developed countries. They also relied heavily on apprenticeships and on-the-job-learning, not only because these were effective methods of acquiring specific skills but because they provided the environmental knowledge and work discipline without which skills alone are frequently wasted.

The Christian churches also contributed to economic development by providing role models for those they taught. The purpose of missionaries is, after all, to influence religious choice rather than to stimulate economic growth. The proximity to the people required for this intimate influence has resulted, however, in a profound cultural change. Confucian attitudes toward commerce and material rewards have been mixed with Christian ideas of a linkage of secular and spiritual success. The rapid growth of Christianity during the period of rapid economic growth and the fact that the largest Christian church in the world is located in Seoul are testimony to the influence of these early missionaries.

CONCLUSION

Every indicator which our research has developed suggests that economic success in the Republic of China and the Republic of Korea resulted from economic policies based on market determined allocations of resources in an environment of well defined and protected property rights.

Formal economic development planning institutions were established in China and Korea but their actual role in the economy was that of follower rather than leader. In Korea, planning in the high foreign aid years was an exercise designed to extract the maximum amount of aid possible from the United States. On Taiwan, the role of macro-economic planners was overshadowed by the decentralized orientation of the aid program and the widely disbursed pattern of entrepreneurial activity.

The foundation upon which later economic success was built consisted of an effective land reform which gave clear title to the people responsible for agricultural output while maintaining secure property rights to other forms of assets throughout the economy. It also consisted of government policies which eschewed direct and pervasive intervention in the economy outside of heavy industry.

In neither of the subject nations was economic aid a determining factor in economic growth. It was never meant to be. In Korea, it was essential to the survival of the Korean people following the Korean War and was seen by the U.S. Congress as an essential part of maintaining Korean defenses against the

Communist North Koreans. On Taiwan, aid eased the transition of the Nationalist government but was initiated as part of the efforts to maintain strategic allies during the Korean War. As much as anything else, the aid program for the ROC was a guarantee that Chiang Kai Shek would provide assistance in the war, including maintaining the real potential for a second front.

With aid now considered an entitlement by many recipient nations it is useful to remember that neither the ROC nor the ROK ever believed that aid would bring growth. They were both happy to have it to be sure, but in both nations aid was seen as a temporary expedient to be used as a bridge to domestically generated prosperity. Especially in the case of Korea, where the U.S. press repeatedly criticized the use of aid and made references to Korea as a "basket case," the national leadership and the people were anxious to gain economic independence.^{2 3}

The success enjoyed by aid programs in Korea and Taiwan was the establishment of market-oriented policies. The aid programs, per se, did not achieve this success. They were a bridge between the market economy of the donor and the policy makers of the recipients. In essence, the ability of the donor to establish the aid program provided a continuing reminder of the wealth which could be achieved by a market economy.

Therefore, if one feature of the aid programs which contributed to their success had to be singled out it would clearly be that they were bilateral. Like the economic relationships which existed on Taiwan between old landlords and new, there was an explicit mutual obligation. The recipient and donor understood that the program would exist only so long as it served the national agenda of both nations. The obligations incurred in such a system provided an incentive for achievement.

The turn to multilateral economic assistance, which occurred just as the ROC and ROK were making their ascent, has severely damaged this necessary linkage between donor and recipient. The faceless bureaucracy of the World Bank and its sister institutions, with no sovereign agenda and no moral purpose cannot hope to provide the example provided by the direct contribution of the American people in Korea and Taiwan. The attempted separation of economic policy from political and national security issues ignores the very basis on which democratic capitalist nations are built. Only through the integration of these elements in a unified program can foreign aid be beneficial.

FOOTNOTES

1. The linkage between aid and political goals was widely discussed in the popular press but apparently ignored in the academic journals of the time. See, for example: "Explosion in Korea: Why U.S. is Worried," U.S. News and World Report, May 2, 1960, pp. 37-38.
2. The economic policy reforms of Park Chung Hee rendered aid levels moot in any case. Positive results of the withdrawal of U.S. assistance was the required switch to reliance on loans and the accompanying requirements for project evaluation. Park's administrators rapidly confined official development assistance to major infrastructure projects under government monopoly control. An interesting side note is the current move away from project lending under so-called "structural adjustment" programs. In essence, these "pay for policy" programs are doomed failure as there exists no expectation that failure to alter policies will result in an aid cut off.
3. Neil H. Jacoby, U.S. Aid to Taiwan, New York, Praeger, 1966.
4. Schmalz, Alfred, "Thanks to Western aid a country utterly wrecked by war is on the way to recovery," The Christian Century, October 20, 1959.
5. The economic assistance program itself helped to continue this happy situation. Since there was only one donor, all of the training which took place outside of the ROC was conducted in the U.S. This meant that there was a steady stream of U.S.-educated personnel coming into the private and public sectors. While the inevitable "brain drain" absorbed some of those trained, almost all of those who returned to Taiwan were U.S. trained and fluent in English.
6. This pattern extends well beyond these household names. One of Korea's top international financial and business executives has a Ph.D. in Finance from Wharton but an MA from Wichita State. In Taiwan, President Lee has a Ph.D. from Cornell but an MA from Iowa State. Practicality has paid off.
7. Cole, David C. and Lyman, Princeton N., Korean Development: The Interplay of Politics and Economics, Harvard University Press, Cambridge, 1971.
8. An even larger factor may have been that there was no representative of the U.S. Department of Agriculture present in either the U.S. Embassy or the USAID mission. These consular roles were assumed by those at JCRR who, due to their close

association with the Chinese, took on the required role of production experts rather than commodity distributors.

9. Taiwan Cement Corporation, Taiwan Paper and Pulp Corporation, Taiwan Agriculture and Forestry Development Corporation and Taiwan Industrial and Mining Corporation. The government provided shares in these corporations to former landowners during the land reform program thereby maintaining their interest in the success of the economy and the government.

10. Jones, Leroy P. and Sakong, Il, Government, Business, and Entrepreneurship in Economic Development, Harvard University Press, Cambridge, 1980, p. 30.

11. Rosenberg and Birdzell have pointed out that "economic growth was a force for democratization and eventually produced a society unmanageable by the old landed elite and their political devices." Taiwan and Korea, perhaps, have demonstrated that the lack of elites and their political devices leads rapidly to economic growth.

12. Krueger, Anne O., The Developmental Role of the Foreign Sector and Aid, Harvard University Press, Cambridge, Mass., 1979. P.21.

13. Cole, David C., and Yung Chul Park, Financial Developments in Korea, 1945-78, Harvard University Press, Cambridge, 1983. This book presents the whole story of the UMM, its size, its role, and the effect of the two times during which the government tried to eliminate or control it. See also: Kim, Joong-woong, "Economic Development and Financial Liberalization in Korea: Policy Reforms and Future Prospects," Working Paper No. 8514, The Korean Development Institute, Seoul, Korea, December, 1985.

14. *ibid*, p.264.

15. Kim, Kwang Suk, and Michael Roemer, Growth and Structural Transformation, Harvard University Press, Cambridge, 1979, p.3.

16. The rapid increase in world sugar prices in 1964 and the increase in banana exports after 1963 were the final impetus for the cut off of U.S. aid in July of 1965.

17. Here we slight those whose motives are not so pure. In many so-called "land reforms" the intentions are simply to place land in the hands of the state, ignoring the demands of the people for clear property rights. "Reforms" such as these merely set the stage for future conflict.

18. There was the inevitable government land grab. The Taiwan Sugar Corporation, a nationalized firm which benefitted greatly from this transfer, continues today as a vestige of that land

grab.

19. The disastrous land confiscation in El Salvador again offers a comparison. The major estates there were actively managed by the landowners. Confiscation of their land (no corresponding property right was provided in El Salvador, only worthless government bonds) was accompanied by the "need" to establish government administered collectives to assure continuity. Workers were provided shares of the collective which were non-transferable. Thus, landowners and workers were alienated from the land as well as from each other. Only the socialist sponsors of the land confiscation program could justly claim victory.

20. Paul W. Kuznets, Economic Growth and Structure in the Republic of Korea, Yale University Press, New Haven, 1977.

21. "Reminder from Korea," Wall Street Journal, May 26, 1960, p. 14.

22. Cole and Lyman, p. 15.

23. Korea differs in this case markedly from the ROC. Chiang Kai Shek's government was not anxious to see the aid program ended as it eschewed any reduction in cooperation between the Nationalist government and its only major ally. Korea faced similarly hostile enemy but had almost total international support. The U.S. press - as during the 1988 Olympics - found itself incapable of recalling why the Korean people had been divided and impoverished following World War II and was unwilling to explore the depth of feelings of the Korean people at having been needlessly sacrificed in the defeat of Japan, its colonial master.